Further surge in gas prices expected

Wholesale gains are not yet fully reflected in pump prices

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WASHINGTON - With the summer driving season still more than a month away, gasoline prices have already started their seasonal climb — jumping 15 percent in the past six weeks alone. And that's just the price you're paying at the pump. With wholesale prices rising even faster, it's a safe bet that the surge in pump prices isn't over, analysts say.

In fact, pump prices are rising along with the temperature, and motorists should expect little relief during this summer's heavy driving period according to a government report released Tuesday.

The official short-term energy outlook from the U.S. Energy Information Administration (EIA) projects the price for regular grade gasoline this summer will average $2.62 a gallon, 25 cents higher than last summer, barring any unexpected supply disruptions. Gasoline prices have soared since February.

Last week, motorists paid on average $2.68 a gallon nationwide for regular, an 18-cent increase in two weeks and 40 cents higher than the national average a year ago.

Growing demand, high crude oil costs, requirements for low-sulfur gasoline and greater demand for corn-based ethanol as an additive all "are expected to keep consumer prices for motor fuels ... high in 2006," said the report.

The high prices are not expected to dampen demand during the April-September heavy driving season. Motorists are expected to use an average 9.4 million barrels of gasoline a day, or 1.5 percent more than last summer, according to the EIA.

"All of these factors are providing a supply challenge to the industry and our ability to meet demand this summer," said EIA Administrator Guy Caruso at a news conference releasing the forecast Tuesday. "We have very low spare productive capacity."

Caruso also estimates that about 19 cents of the 25 cent increase in pump prices will come from higher crude oil costs.

The seasonal rise in gas prices — from the lows in the dead of winter to the highs in spring and early summer — has averaged about 55 percent each year for the past 20 years, according to Tom Kloza, who tracks pump prices at the Oil Price Information Service. And while pump prices are up roughly 50 cents a gallon since early December, wholesale prices are up more like 75 cents, he said.

"When you have 75 cents of wholesale increases and only about 50 cents of retail you've got about 25 cents of catching up to do," said Kloza.

One reason pump prices haven't kept up is that the rapid rise in wholesale prices has made it harder than usual for retailers to pass along the increase to their customers.

“The retailers are under water,” said Kloza. “If you’re a chain — whether you’re Costco or the local chain — right now there’s a very good chance that you’re losing money on the gasoline that’s going out of your station because you’re replacing it at a price that costs more.”

As forecasters try to nail down what will happen in the coming months, a lot will depend on what happens in the next several weeks, as U.S. refiners wrestle with a series of production headaches that could put a crimp in supplies.

April usually brings a switch from conventional gasoline sold only in winter months to the so-called reformulated gas mandated in many parts of the country to cut air pollution. That usually means refiners, distributors and wholesalers draw down stocks of winter fuel — which can’t legally be sold in summer — flushing the old fuel out of the system before moving the new summer blends.

This year, they’ve got an added headache. In the past, reformulated gasoline relied on an additive known as MTBE which, after it was found to pollute groundwater, is now being phased out as this year’s summer gasoline moves through the system. With supplies already tight, the loss of that additive cuts overall gasoline supplies by about 400,000 barrels a day — or the equivalent of four to five large refineries, according to the National Petrochemical and Refiners Association.

The replacement of choice for MTBE is corn-based ethanol. But ethanol is much more costly to transport because it has to be shipped by rail instead of via pipelines. It also takes about twice as much ethanol by volume to replace MTBE, according to the NPRA. Though Congress enacted generous subsidies last year to boost ethanol production, it's not clear that supplies will be adequate in some regions.

That could bring pump price spikes in those areas of the country — including parts of Texas, northern Virginia and the Northeast — that are most heavily effected the MTBE phase-out. (Other markets, like California New York, and parts of the Midwest, have already eliminated MTBE.) So while average prices are not expected to rise much above $3 a gallon, isolated markets could see higher spikes.

Some refiners are also shutting down production now to begin a round of seasonal maintenance that was deferred last fall after back-to-back hurricanes knocked a number of major refineries off line and put added pressure on the rest of the industry to run flat out. Some analysts are predicting that higher-than-normal refinery shutdowns could put a crimp in gasoline inventories in coming weeks.

Then there’s the uncertainty surrounding the price of crude oil — which is now approaching $70 a barrel. As the world economy remains strong, demand for oil is growing faster than producers can expand output.

OPEC producers are believed to be pumping about as fast as they can. Political instability in Nigeria and Iraq continue to hamper production and could bring even lower levels if attacks on oil facilities widen. And U.S. producers are still struggling to restore oil production damaged by last falls hurricanes. As of this week nearly a quarter of oil production in the Gulf of Mexico production is still shut in, according the U.S. Minerals Management Service. Since last August, some 144 million barrels of crude have been lost of hurricane damage, or about a quarter of the Gulf’s annual output.

Oil traders have already bid up crude prices because of uncertainty about the reliability of supplies. Any further crimp in production could send crude prices spiking and pump prices even higher.

With gasoline prices up sharply, refiners are enjoying their biggest profit margins in years — about $12 on every barrel they produce, according to Jacques Rousseau, an energy analyst with

Friedman Billing and Ramsey in Houston. That means about 28.6 cents a gallon of the pump price represent refiner profit.

With all of the wild cards on the production side of the equation, a lot depends on whether consumers find ways to squeeze more miles of out of each gallon and cut back on trips to the pump. Gasoline consumption took a noticeably drop last fall after hurricanes Katrina and Rita sent prices higher, and sales of gas guzzling SUVs have been sharply lower since then. But demand picked up again this winter as pump prices fell.

“When you get north of $2.75 you start to see a demand response, which is to say demand is a little more temperate,” said Kloza. “People get pissed off.”

The Associated Press contributed to this report.

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